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TAGS: EFIN EAID PREL IZ JO
SUBJECT: JORDAN IMF TEAM REVIEWS IRAQ SCENARIOS

Classified By: ECON COUNSELOR TOM GOLDBERGER REASONS 1.5 (B) AND (D)

SUMMARY

¶1. (C) According to an IMF team visiting Amman this week to discuss the Fund's program for 2003, economic disruptions from military operations against Iraq could increase Jordan's external financing need by $1.2 billion in 2003. Substantial external assistance could over time, however, help smooth the economy's adjustment to higher oil prices. The Fund is generally pleased with Jordan's economic growth and progress on economic reform and privatization, but needs to see speedier movement on pension reform before it can commit to post-2003 funding. END SUMMARY.

PROGRAM AND CONTINGENCIES

¶2. (C) At their request, IMF team members Joannes Mongardini, Economist--Middle East Department, Ashok Bhatia, Economist-Treasurer's Department, and Todd Schneider, Policies Department, briefed the Economic Section and USAID at the Embassy November 4. The mission is in Amman for two weeks to review Jordan's performance under stand-by arrangements and to discuss the Fund's program in Jordan for ¶2003. In so doing, they are looking closely at the impact on the balance of payments and the budget of possible military operations against Iraq. The mission's findings will be discussed by the IMF Board in March.

IRAQ

¶3. (C) Mongardini said the potential consequences of military action in Iraq could be severe. He said the loss of the oil grant/subsidy from Iraq, the disruption of trade, temporary capital flight due to political uncertainty, and a reduction in GDP growth might mean a $1.2 billion increase in the Jordanian economy's external financing need for next year over and above the baseline. Mongardini allowed that the Central Bank of Jordan (CBJ) could use reserves to partially cover this, but that would only plug half the gap. To avoid a brutal economic shock, the rest, he said, would have to be made up in additional support by donors and international financial institutions.

¶4. (C) The team said that the key issue was smoothing the adjustment of petroleum product prices to market levels. Along those lines, Mongardini said, the team had just met with Jordanian Minister of Finance Michel Marto, who was "very happy" over recent discussions in Washington regarding USG intentions to assist Jordan, but did not provide any details. But regardless of the source of external financing, the economy would need time to adjust to petroleum prices that would be 50-60% higher than current prices, as well as the loss of budget revenue due to the loss of the "oil surplus". Mongardini estimated that a smooth adjustment would entail increasing prices to market levels over a two to three year period.

¶5. (SBU) Mongardini also said the Fund was going to advise the Ministry of Finance to increase general sales and excise taxes on petroleum products to end the budget's dependence on the oil surplus. This would give the government flexibility to subsidize, for example, lower kerosene prices for the poor by raising taxes on other petroleum products.

OTHERWISE, THE NEWS IS GOOD

¶6. (SBU) Mongardini said that, Iraq aside, "things looked good". The government was well on track to attain its target of 5% GDP growth for the year, with preliminary Ministry of Finance figures showing 5.3% growth for the third quarter thanks to an impressive 11% increase in tourism receipts and strong exports, up 77% over last year to the U.S. alone. Mongardini said that although domestic demand seemed to be weak and domestic revenues a bit below target, the government was on track for deficit reduction, as it is holding back on

capital expenditures and other spending.

¶7. (SBU) In a related issue, the team said the Fund was hopeful that the government would merge the Program for Social and Economic Transformation (PSET), an off-budget plan to fund various economic development projects via grants and privatization proceeds, into the regular budget next year. Mongardini said the danger is that the PSET would take on a "life of its own". He said the Fund is encouraging the government to base project spending on secured finance, but that Marto does not quite understand how integrating the PSET into the budget would work at this point. Mongardini said the IMF proposed that "the funding the government could count on" should be in the budget, and that the government could still have a "wish list" of proposed projects should additional funds become available. He emphasized that the Fund needed assurances from Jordan that this integration would happen.

PENSION REFORM

¶8. (C) Mongardini told us that some progress had been made in pension reform. He said that King Abdullah signed a decree October 10 increasing the retirement age by six months per year for the next ten years. The enrollment of new military recruits in the government's military pension plan has not yet been frozen, but a plan to enroll recruits in the Social Security Corporation is currently under active discussion and could be implemented by year's end, according to Mongardini.

¶9. (C) The team said the more difficult issue is the disability pension for retirees in the military system. Currently, 85% of military retirees get both a regular pension and disability. Mongardini said a Fund-endorsed plan was on the table that would move disability certification from the military to an independent board of doctors under the direction of the ministry of Health. The plan is closely held, however, as the military is concerned that personnel might retire now to take advantage of current regulations. Action in Iraq, he added, would "stop everything". But he said the IMF "will use all the leverage it has" regarding the pension issues, and will not go ahead with post-2003 funding unless both plans are met.

PRIVATIZATION

¶10. (SBU) Bhatia said that privatization plans for next year appear to be headed in the right direction. He said the unbundling of the electricity sector had been finished. The government planned to sell the generation and distribution companies next year, and expected "a substantial amount" of privatization proceeds as a result. As the government wants to retain the power grid in state hands, the transmission company will not be offered. Bhatia said the government has shortlisted six potential bidders for the Arab Potash Company, with bids due at the end of January 2003 and the final sale to take place in March 2003. Talks regarding the sale of Jordanian Phosphate Mines Company to the Potash Company of Saskatchewan were in "the third round", according to Bhatia. But, he added, the government was also considering restructuring the company over the next 12-14 months should negotiations stall. Bhatia claimed there was also some hope the sale of Royal Jordanian Airlines could move forward next year. All told, Bhatia said privatization receipts next year could go as high as $560 million.

JORDAN TELECOM IPO

¶11. (SBU) The Team said the Fund was "quite pleased" that so many investors bought shares in Jordan Telecom (JTC), as it opens doors for IPOs in the future. Marto told the team he was also pleased with the offering, and predicted a closing price of JD 2.5 ($3.50) per share after yesterday's first day of public trading on the Amman Stock Exchange. (Note: JTC closed at JD2.45.) Bhatia called the decision by the Social Security Corporation (SSC) to purchase 5% "very gutsy", but said with its currently high level of liquidity, the SSC could well afford the move. Bhatia said the government was likely to offer another 10-15% of JTC for sale next year.

TECHNICAL ASSISTANCE

¶12. (SBU) Regarding technical assistance, the Fund is sending a tax advisor to the Ministry of Finance (MOF), arriving the weekend of November 7, to advise the Jordanian government on setting up a new income tax system, one that

would represent what Mongardini called a "clean slate". The advisor will be resident at the Ministry for at least one year. In addition, the Fund will provide assistance to the Ministry on a treasury accounting system.

¶13. (SBU) Most importantly, the MOF has agreed to accept a Financial Sector Assessment Program Mission in March and May of 2003. Jointly run by the IMF and the World Bank, the assessment will comprehensively examine the sector for soundness and vulnerabilities. The total report will remain strictly confidential, but the substance will make up part of the Fund's Article IV consultations regarding Jordan in November, 2003.

COMMENT

¶14. (SBU) The Fund is generally pleased with Jordan's economic performance. That said, it is also clear that momentum in pension reform and privatizations is imperative for the government to retain the IMF's continued support. We expect that forward progress will continue, but action in Iraq could well at least temporarily derail Jordan's economic growth and progress on reform.
GNEHM